

## DBRS Morningstar Confirms the City of Madrid at “A”, Stable Trend

### SUB-SOVEREIGN GOVERNMENTS

DBRS Ratings GmbH (DBRS Morningstar) confirmed the Long-Term Issuer Rating of the City of Madrid (Madrid) at "A" and the Short-Term Issuer Rating at R-1 (low). The trend on all ratings remains Stable.

### KEY RATING CONSIDERATIONS

Madrid's ratings are underpinned by (1) Spain's capital city's large and diversified economy; (2) Madrid's very strong financial performance over the last decade and the city's sound medium-term fiscal outlook; and (3) the significant improvement in Madrid's debt metrics to a relatively favourable level and its effective public sector debt management strategy. DBRS Morningstar also views positively Madrid's institutional environment, including a rather predictable and well calibrated financing framework for Spanish municipalities. Madrid's ratings also benefit from DBRS Morningstar's assessment of a high likelihood of support stemming from the Kingdom of Spain (A, Stable). DBRS Morningstar takes the view that despite its intrinsic strengths, the City of Madrid does not have the constitutional protection to be rated above the sovereign rating and its ratings are therefore capped by the Kingdom of Spain's ratings.

The Stable trend reflects DBRS Morningstar's view that risks to the ratings are currently balanced. The economic outlook remains clouded with uncertainties to inflationary pressures and the complete resolution of the healthcare situation. Although Madrid, thanks to its very strong financial position, has so far weathered the economic and financial impacts of the Coronavirus Disease (COVID-19) pandemic well, DBRS Morningstar will monitor the speed of full economic recovery and the potential negative economic and budgetary consequences of the current inflationary environment. These challenges are compensated for by the city's very strong economic and tax bases, its fiscal flexibility and Madrid's strong financial management track record.

### RATING DRIVERS

The ratings could be upgraded if the Kingdom of Spain's ratings were upgraded.

The ratings could be downgraded if any or a combination of the following occur: (1) the Kingdom of Spain's ratings were downgraded; (2) although currently unlikely given its intrinsic strengths, a structural weakening in the city's fiscal performance, leading to fiscal deficits widening and a sustained and material rise in public sector debt.

### RATING RATIONALE

The Economic Recovery Is Under Way but Uncertainties Remain Given Inflationary Pressures in Europe

The COVID-19 outbreak significantly affected the Spanish and the regional economies in 2020. Madrid's gross domestic product (GDP) decreased by 11.0% in 2020, in line with Spain's 10.8% decline, largely reflecting the extent of the healthcare crisis, the stringency of the lockdown that followed, and the high concentration of economic activity in sectors severely affected such as tourism.

In 2021, Madrid's GDP rebounded by 6.5%, according to the region's estimates, outperforming the 5.1% for Spain's GDP, driven by a strong rebound in the construction and services sectors. The regional economy is expected to continue recovering in coming years, broadly in line with the national average. DBRS Morningstar expects a strong tourism performance and solid job creation to support Spain's GDP but inflationary pressures, particularly higher energy prices, increasing funding costs, and a weaker external backdrop are likely somewhat to weigh on growth this year. The European Commission (EC) revised its growth projections for Spain upwards to 5.5% in 2022 and to 1.4% in 2023 in its Winter 2022 projections, from previously 4.5% and 1.0% respectively.

Despite the strength of the COVID-19 shock, the supportive measures taken by the national government during the pandemic as well as the financial resources expected from the Next Generation EU (NGEU), including the Recovery and Resilience Facility (RRF) and REACT-EU funds, should continue to alleviate the long-term impact of the pandemic and support the recovery. DBRS Morningstar therefore takes the view that long-term risks related to COVID-19 have receded, as exemplified by the strong performance of the labour market in recent months. As of Q2 2022, Madrid's unemployment rate had largely recovered its pre-pandemic level, standing at 10.2% compared with 10.0% at the end of 2019 and a peak of 13.5% in Q4 2020. Going forward, the impact of higher inflation on consumption and investment as well as the speed of absorption of EU funds will remain key areas of focus for DBRS Morningstar to assess the strength of the region's economy.

#### Madrid's Fiscal Performance Slightly Deteriorated in 2022 But Improvement is Expected From 2023

After several years of strong fiscal performance and surpluses, the city of Madrid's provisional 2022 budget execution, points to a deficit, but it should remain below 5% of operating revenues. Despite the weakening fiscal performance, the impact on the debt position has been limited and DBRS Morningstar still views positively Madrid's strong financial position. Most of the decline in the city's financing surplus over the last few years reflected the flattening of the city's revenue and the overall increase in the city's level of expenditure, of which the share of capital expenditure has been growing.

For 2023, DBRS Morningstar continues to take the view that the fiscal outlook for the city of Madrid remains sound. This was confirmed by the Independent Authority for Fiscal Responsibility (AIReF) in its October 2023 Complementary Report on largest Spanish local governments' budgetary performance. The report outlines that Madrid's fiscal surplus under national accounting standards could improve in 2023 and reach EUR 146 million versus EUR 71 million in 2021. Going forward, maintaining a sound fiscal performance will remain a key feature for the city's credit profile. In particular, containing structural expenditure growth in the context of continued inflation and heightened pressure on civil servants' wages will remain important for the city to maintain strong financial results. Overall, despite the challenges, DBRS Morningstar considers Madrid's fiscal performance and outlook as strong, supported by Madrid's track record and still considerable fiscal space.

#### Madrid's Debt Sustainability is Very Strong, Supported by Sound Debt and Liquidity Management

The city's debt has decreased very rapidly over the last decade, with a more than fourfold decline in Madrid's debt stock between 2012 and 2022, from EUR 7.7 billion to EUR 1.7 billion with a marked improvement until 2018 and a slower but constant decrease in recent years. However, the city has recorded a moderate deficit in 2022 which translated into a limited debt increase of EUR 45 million. In line with this very significant decline over the last decade, the city's debt sustainability has significantly strengthened, reflecting a relatively low debt stock, the very wide economic and tax bases, as well as strong access to diversified financing sources. With a debt ratio of 39% of operating revenues at the end of 2022, the city's debt remains substantially below the 75% limit set in the national government's Budgetary Law for 2013 which would prompt rebalancing measures to bring down the local debt.

Madrid's liquidity and debt management is also strong. The city maintains diversified funding sources through bank loans with a wide range of institutions and debt issuances. At the end of 2022, the city had EUR 300 million in bond issuances, or about 17% of its debt stock. It also maintains a relatively long average life on its debt, at 6.8 years at the end of 2021, with a smooth amortisation profile and more than 80% at fixed rates. Finally, the liquidity position is deemed strong, and Madrid maintains flexibility throughout

the year with the addition when necessary of credit line facilities. The city does not have any guaranteed debt, which limits the risk of contingent liabilities although there is a public service contract on the main municipal highway (M30) which is currently outsourced to a private operator and may expose the city to some financial costs if the next government decides to manage it directly (current contract should be renewed or finalised in 2024-2025 period).

On top of it, its strong liquidity position, DBRS Morningstar views positively the availability of central government's financing facilities, although not currently used by Madrid to finance its capital expenditure programme, which represent a potential financing backstop for the city.

## ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

### Social (S) Factors

The Passed-through Social credit considerations have a relevant effect on the ratings, as the social factors affecting the Kingdom of Spain's ratings are passed-through to the City of Madrid.

There were no Environmental or Governance factors that had a significant or relevant effect on the credit analysis.

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>.

## RATING COMMITTEE SUMMARY

DBRS Morningstar European Sub-Sovereign Governments Scorecard generates a result in the AA (high) – AA (low) range. Additional considerations factored into the Rating Committee decision included DBRS Morningstar's view that the City of Madrid does not have the constitutional protection to be rated above the sovereign rating. In addition the Rating Committee considered the likely increase in the debt position of the city in the next two to three years, the remaining macroeconomic uncertainties and the risks to the fiscal outlook, particularly on the expenditure side.

The main points discussed during the Rating Committee include the city's economic growth prospects and the impact of the inflationary environment, Madrid's public finances, the city's debt and liquidity profile, the likelihood of support from the national government, if ever needed.

For more information on the Key Indicators used for the Kingdom of Spain, please see the Sovereign Scorecard Indicators and Building Block Assessments: <https://www.dbrsmorningstar.com/research/410073/spain-kingdom-of-scorecard-indicators-and-building-block-assessments>

The national scorecard indicators were used for the sovereign rating. The Kingdom of Spain's rating was an input to the credit analysis of the City of Madrid.

### Notes:

All figures are in euros (EUR) unless otherwise noted.

The principal methodology is the Rating European Sub-Sovereign Governments (August 12, 2022) <https://www.dbrsmorningstar.com/research/401273/rating-european-sub-sovereign-governments>. In addition DBRS Morningstar uses

the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings <https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings> (May 17, 2022) in its consideration of ESG factors.

The sources of information used for this rating include the City of Madrid for financial position for the 2015-21 period (annual accounts for the 2015-21 period), annual budgetary execution documents for 2022, and debt structure documentation for the 2015-21 period, Bank of Spain for the debt stock during the period between 2015 and 2021 (Debt according to the excessive deficit procedure documents), Independent Authority for Fiscal Responsibility (AIReF) for its estimate of the 2023 local governments' budgetary performance (Informe complementario de evaluación individual sobre la ejecución presupuestaria, deuda pública y regla de gasto 2023 de la corporaciones locales, October 2023), Instituto Nacional de Estadística (INE), Ministry of Finance; the 2020 European Social Progress Index from the European Commission. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: <https://www.fca.org.uk/firms/credit-rating-agencies>.

The sensitivity analysis of the relevant key rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/410279>.

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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## Ratings

### Madrid, City of

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
24-Feb-23	Long-Term Issuer Rating	Confirmed	A	Stb	<b>EU</b> <b>U</b>
24-Feb-23	Short-Term Issuer Rating	Confirmed	R-1 (low)	Stb	<b>EU</b> <b>U</b>

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